

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-02 INR-07 L-03

NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06 SAB-01

AID-05 IGA-01 EB-07 COME-00 FRB-03 TRSE-00 XMB-02

OPIC-03 CIEP-01 LAB-04 SIL-01 OMB-01 /086 W

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R 020748Z OCT 75

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC 8459

INFO AMCONSUL JERUSALEM

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E.O. 11652: NA

TAGS: EAID, EFIN, AFSP, IS

SUBJ: GOI'S NEW ECONOMIC MEASURES

REF: A) TEL AVIV 6207; B) TEL AVIV 6170

1. SUMMARY: MINISTRY OF FINANCE BELIEVES RECENT ECONOMIC MEASURES WILL REDUCE EXCESS LIQUIDITY IN ECONOMY AND REVERSE DECLINE IN EXCHANGE RESERVES. INFLATIONARY IMPACT WILL BE APPROXIMATELY FIVE PERCENT. RELATIVELY MILD PACKAGE OF MEASURES, WHICH GENERATED ONLY MODERATE OPPOSITION, HAS NOT ENDED SPECULATION AGAINST ISRAELI POUND. IT IS HOPED, HOWEVER, THAT GOI WILL NOW HAVE BREATHING SPELL TO PREPARE NEEDED POLICY CHANGES.

2. EPHRAIM DOVRAT, ECONOMIC ADVISOR TO MINISTER OF FINANCE, PROVIDED ECON COUNSELOR FOLLOWING BACKGROUND INFORMATION ON ECONOMIC MEASURES ANNOUNCED BY GOI SEPTEMBER 28. MEASURES WERE NECESSITATED BY DECLINE IN RESERVES, GROWING BALANCE OF PAYMENTS DEFICIT, AS WELL AS NEED TO NEUTRALIZE RECENT INJECTIONS OF MONEY INTO ECONOMY BECAUSE OF RECENT INCOME TAX REFORM AND
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COST OF LIVING ADJUSTMENT. THEY WILL MOP UP APPROXIMATELY

IL 1.2 BILLION FROM ECONOMY. SOME IL 4.5 BILLION
OF BUDGETARY DEFICIT OF ABOUT IL 6 BILLION IS EXPECTED
TO BE ABSORBED BY ISRAEL'S BALANCE OF PAYMENTS DEFICIT.
ACCORDING TO DOVRAT, THIS IS BECAUSE IMPORTERS CONVERT
IL INTO FOREIGN EXCHANGE AND THEREBY SOAK UP LIQUIDITY
GENERATED BY BUDGETARY DEFICIT. END SUMMARY.

3. NET BUDGETARY IMPACT OF NEW MEASURES WILL BE
REDUCTION OF DEFICIT BY ABOUT IL 600 MILLION. HOWEVER,
IL ONE BILLION BUDGET DEFICIT REMAINS. DOVRAT WAS NOT
CLEAR ABOUT HOW THIS IL ONE BILLION WOULD BE FINANCED
BUT IMPLIED THAT IT WOULD BE DONE THROUGH IMPOSITION
OF VALUE-ADDED TAX (VAT) EARLY NEXT YEAR.

4. FINANCE MINISTER RABINOWITZ HAS SET A GOAL OF
JANUARY 1 FOR VAT IMPLEMENTATION. DOVRAT THOUGHT THAT
IT MIGHT SLIP A MONTH OR TWO. WHEN ASKED ABOUT HISTADRUT
OFFICIAL'S STATEMENT TO EMBOFF THAT VAT WOULD BE
IMPLEMENTED AT LEVEL OF THREE PERCENT, DOVRAT DID NOT
DISAGREE. HE POINTED OUT THAT FOR EVERY ONE PERCENT
OF VAT, AN ESTIMATED IL 500 MILLION IN REVENUE WOULD
RESULT. HOWEVER, FINAL DECISION ON TIMING AND RATE OF
VAT WILL BE A FUNCTION OF ECONOMY'S STATE AT END OF
YEAR. VAT, HE SAID, WILL NOT SUBSTITUTE COMPLETELY FOR
PURCHASE AND OTHER INDIRECT TAXES.

5. DOVRAT MINIMIZED CONFLICT BETWEEN GOI AND HISTADRUT
IN WORKING OUT PACKAGE OF NEW MEASURES. GOI HAD
FAVORED INCREASING PRICES ON ALL BASIC COMMODITIES
BUT, IN FACE HISTADRUT OPPOSITION, AGREED INCLUDE
ONLY FUEL, WATER AND ELECTRICITY IN PACKAGE. ALSO ,
GOI HAD PROPOSED TEN PERCENT ACROSS-THE-BOARD INCREASE
PURCHASE TAX BUT COMPROMISED WITH HISTADRUT AND AGREED
TO FIVE PERCENT INCREASE FOR ITEMS SUCH AS CLOTHING,
TEXTILES, HOUSEWARES, CLEANING MATERIALS AND CHEAPER WINES.

6. IN DISCUSSING WHETHER OR NOT A LARGER DEVALUATION
MIGHT NOT HAVE BEEN NEEDED, DOVRAT SAID THAT HE PERSONALLY
HAD NOT FAVORED ANY DEVALUATION. HE DOUBTED
THAT TEN PERCENT DEVALUATION WOULD HAVE SIGNIFICANT EFFECT
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ON ISRAEL'S EXPORTS BECAUSE REAL REASON
FOR ISRAEL'S EXPORT STAGNATION WAS WORLD RECESSION.
MOREOVER, GOI WILL CONTINUE WITH POLICY OF CREEPING

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NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06 SAB-01

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DEVALUATIONS WHICH WILL RESULT IN TOTAL DEVALUATION OF
AT LEAST 27 PERCENT OVER NEXT 12 MONTHS, WHICH SHOULD
PRESERVE COMPETITIVE POSITIN OF ISRAELI EXPORTS.

7. SUCCESS OF THESE NEW ECONOMIC MEASURES DEPENDS
IN PART ON WHETHER OR NOT EXPORTS INCREASE. THIS IN
TURN WILL BE FUNCTON OF DEGREE OF SLOW DOWN IN ECONOMY
AND SHIFT OF RESOURCES TO EXPORT SECTOR, AND RATE OF
INFLATION. DOVRAT ESTIMATED INFLATIONARY IMPACT OF
RECENT MEASURES AT FOUR TO SIX PERCENT. HIS PRESENT
ESTIMATE OF INCREASE IN CPI DURING 1975 IS 23 TO 25
PERCENT. MOREOVER, \$250 MILLION LOSS IN FOREIGN EXCHANGE
RESERVES SHOULD BE RECOVERED.

8. WHEN ASKED ABOUT SHORTAGE OF 28,000 WORKERS
MENTIONED BY RABINOWITZ PARA 3, REF A, DOVRAT EXPLAINED
THAT THIS WAS RESULT OF INCRASED MILITARY RESERVE
SERVICE, FACT THAT MORE ISRAELIS ARE STUDYING AND
STUDYING FOR LONGER PERIODS OF TIMEAND REDUCED
IMMIGRATION TO ISRAEL. LABOR FORCE IN FACT INCREASED
BY LESS THAN 1,000 LAST YEAR.

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9. HISTADRUT OFFICIALS HAVE SAID PUBLICLY THAT COST OF LIVING AGREEMENTS WOULD HAVE TO RENEGOTIATED IF NEW MEASURES RESULTED IN INCREASE IN COST OF LIVING IN EXCESS OF VIE PERCENT BY END OF OCTOBER. HOWEVER BOTH HISTADRUT AND UNIO OFFICIALS TOLD EMBOFF THAT DESPITE SOME HISTIONICS, THEY DID NOT EXPECT THAT PUBLIC LABOR CRITICISM OF MEASURES REPRESENTED REAL THREAT TO INDUSTRIAL PEACE OR MAINTENANCE OF MODERATION REGARDING PROSPECTIVE WAGE DEMANDS. DISCUSSIONS ON NEXT YEAR'S WAGE AGREEMENTS ARE, IN ANY CASE, SCHEDULED TO PEN IN NOVEMBER. BOTH HISTADRUT AND MANUFACTURERES' ASSOCIATION ARE OPTIMISTIC THAT UNIONS WILL NOT SERIOUSLY CHALLENGE NEW GOVERNMENT PAQQXNUK ALTHOUGH SOME OF THE MORE MILITANT PROFESSIONAL GROUPS ARE LIKELY TO CONTINUE EFFORTS TO UNDERMINE SPIRIT OF ACCOMODATION.

10. COMMENT: NEW ECONOMIC MEASURES HAVE GENERATED ONLY MODERATE ADVERSE REACTION FROM POLTICIAL OPPOSITION AND LABOR UNIONS BECAUSE PACKAGE STOPS FAR SHORT OF QUOTE EMERGENCY ECONOMIC PROGRAM UNQUOTE WHICH BOTH MINISTER OF FINANCE RABINOWITZ AND COMMRCE MINISTER BAR-LEV SAID WOULD BE NECESSARY IF THER WERE MAJOR SHORT-FALL IN US AID. AS REPORTED IN EFTELS, MOST ECONOMIC WRITERS REGARD NEW MEASURES AS SIMPLY ANOTHER IN SERIES OF STEPS WHICH PROVIDE BRIEF IMPORVEMENT BUT DO LITTLE TO RESOLVE ISRAEL'S BASIC ECONOMIC PROBLEMS. IN FACT, SPECULATION AGAINST ISRAELI POUND CONTIUES, WITH NATAD AND BLACK MARKET DOLLAR RISING TO IL 7.70 AND 8.30 RESPECTIVELY ON SEPTEMBER 30.

11. PERHAPS BIGGEST FAULT IS THAT MEASURES WILL DO LITTLE TO ENCOURAGE SHIFT OF RESOURCES TO EXPORT SECTOR, WHICH SHOULD BE NUMBER ONE OBJECTIVE OF ISRAEL'S ECONOMIC POLICY MAKERS. ON BRIGHTER SIDE, MEASURES HOPEFULLY WILL PROVIDE BREATING SPELL WHICH WILL BE USED TO PREPARE FOR NEEDED POLICY CHANGES. ONE AREA DESERVING SCRUTINY IS QUESTION OF SUBSIDIES FOR BASIC COMMODITES. CURRENT BUDGET CONTAINS IL 1.9 BILLION TO SUBSIDIZE BREAD, MILK, EGGS, ETC., FOR BENEFIT OF ALL INCOME GROUPS, WEALTHY AS WELL AS POOR.
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